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No. 369

In the Supreme Court of the United States

OCTOBER TERM, 1958

R. H. MACY & CO., INC., L. BAMBERGER & CO., DAVISON-PAXON CO., AND THE LASALLE & KOCH COMPANY,
PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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OPINIONS BELOW

The opinions of the court of appeals reversing the judgment of the district court (Pet. App. 2–12) and denying taxpayers' petition for rehearing (Pet. App. 14–16) are reported at 255 F. 2d 884. The opinion of the district court (Pet. App. 18–40) is reported at 148 F. Supp. 377.

JURISDICTION

The judgment of the court of appeals was entered on May 12, 1958 (Pet. App. 13). Taxpayers' petition for rehearing was denied on June 16, 1958 (Pet. App.

17). Taxpayers' petition for a writ of certiorari was filed on September 15, 1958. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254 (1).

QUESTION PRESENTED

Whether taxpayers were entitled in 1948 to recompute their taxable income for the fiscal year ended January 31, 1942, using the LIFO inventory method, where they had failed to file an election to do so prior to March 10, 1943, as required by the statute and regulations.

STATUTE AND REGULATIONS INVOLVED

The pertinent provisions of the Internal Revenue Code of 1939 (§ 22 (c) and (d)) and of Treasury Regulations 103 (§§ 19.22 (c)–8 and 19.22 (d)–1 through 19.22 (d)–3) are set forth in the Appendix, *infra*, pp. 19–25.

STATEMENT

In 1948 Macy[1] filed an "election" of the LIFO method of accounting for its fiscal year 1942 and subsequent years and filed a claim for refund for 1942 on that basis. The Commissioner denied the claim for refund on the ground that under the statute and regulations the election for 1942 had to be made prior to March 10, 1943. Macy sued for refund, claiming that the cut-off date was inapplicable to it because the Commissioner had, until 1948, when his position

[1] Taxpayers are collectively referred to in the opinions below, and sometimes herein, simply as "Macy," since the taxpayers other than R. H. Macy & Co., Inc., have been liquidated and Macy stands in their place and stead with respect to the claims here involved (Pet. App. 55, 62).

was rejected by the Tax Court, asserted that the statute did not authorize "retail method" taxpayers, like Macy, to use LIFO techniques. The court of appeals held that Macy was barred from recomputing its 1942 taxes on the LIFO basis because of its failure to make a timely election. The material facts, as reflected in the opinions below (Pet. App. 2–12, 14–16, 18–40) and the stipulation of facts (Pet. App. 41–62), may be summarized as follows:

Under the LIFO (last-in-first-out) method of inventory valuation, the closing inventory, to the extent that it replaces the opening inventory, is assigned the same cost as the opening inventory; only the increase in the inventory, if any, is deemed to have been purchased during the year and is valued at current costs. Under the FIFO method (first-in-first-out), the opening inventory is assumed to have been the first sold during the year and the closing inventory is treated as consisting of the items purchased during the year, and hence is valued entirely at current costs. During a period of rising costs, the LIFO method is distinctively advantageous to a taxpayer, for, in effect, he is not required to include, as profit, increases in the value of the inventory (Pet. App. 3, 43–45).[1]

In filing its tax return for its fiscal year 1942, Macy, as it had in previous years, computed its income on the

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[1] This is true, in essence, because any costs incurred during the year which are attributed to the closing inventory cannot be deducted as part of the cost of goods sold. Thus the higher the closing inventory valuation, the lower the cost of goods sold and the higher the taxable income.

basis of the "retail method" of inventorying (Pet. App. 5). Under this method no records are kept of the kind or number of items on hand. The store simply adds up the retail prices of all the items on hand at the end of the year in each department and records the resulting total valuation as the "retail inventory." To arrive at a "cost inventory" this figure is then reduced by the standard percentage of mark-up in the department (Pet. App. 42–43, 45–46). Since this method is based on the current retail prices, it is essentially a FIFO method—the closing inventory reflects current costs rather than the cost of the opening inventory. To adjust this method to LIFO concepts, as Macy is seeking to do here, the closing retail valuation is "deflated" by means of a price index to beginning-of-the-year price levels and then compared to the opening inventory (Pet. App. 5). To the extent that the "deflated" value of the closing inventory is no greater than was the retail value of the opening inventory it is assigned the same cost; only the excess is revalued at year-end prices.[2] In effect, this adjustment treats all of the items in the department as being fungible and carries over the cost of the opening inventory without regard to whether the closing inventory includes the same kinds or numbers of items as the opening inventory (Pet. App. 19–20).

The use of the LIFO method of accounting for income tax purposes was first generally authorized by § 22 (d) of the Internal Revenue Code of 1939.

[2] For a detailed explanation of the application of LIFO concepts to the retail method of accounting, see *Hutzler Brothers Co.* v. *Commissioner*, 8 T. C. 14.

Section 22 (d) (2) (A) required taxpayers to make a binding election to use the method authorized by filing an application in the time and manner prescribed by the Commissioner. The Commissioner implemented the election provision in § 19.22 (d)–3 of Treasury Regulations 103, which, as amended, required that the election be filed with the return for the first year in which the method was to be used, except that the election could be made at any time prior to March 10, 1943, for any years returned before that date.[4] Upon filing such an election, the statute authorized the taxpayer to inventory "goods specified in the application" by treating "those remaining on hand at the close of the taxable year as

[4] The reason why taxpayers were given until March 10, 1943, to make an election for prior years was as follows: Section 22 (d) (2) (B) of the 1939 Code had originally precluded taxpayers from using the LIFO method if they had issued mid-year financial reports on another basis. The Revenue Act of 1942, effective October 21, 1942, had retroactively amended the section to eliminate the bar of inconsistent mid-year reports (though it retained the bar arising from inconsistent annual reports). In order to permit taxpayers who, because of inconsistent mid-year reports, had been barred from electing LIFO when they had filed their returns to take advantage of this retroactive amendment, the Commissioner amended the regulations to give such taxpayers 90 days after the amended regulations were issued (*i. e.*, until March 10, 1943) within which to make a retroactive election for years for which returns had already been filed. Macy was one of the taxpayers affected by the amendment to the statute, since for its fiscal year 1942 it had issued mid-year, but not annual, reports on a basis other than LIFO. Thus, although it had already filed its return for its fiscal year 1942 on a FIFO basis, it was given a further opportunity, until March 10, 1943, to make a retroactive election for that year.

being * * * those included in the opening inventory * * * to the extent thereof" (§ 22 (d) (1) (B)).

During the course of 1942, Macy and other retailers held numerous conferences with representatives of the Treasury Department in an attempt to persuade the Commissioner that the use of price indices to make "LIFO" adjustments to retail method inventories was within the accounting method authorized by § 22 (d). In these informal conferences (and, indeed, until 1948), the Commissioner took the position that the application of the statutory method required that the "goods" so to be inventoried be identified so that the "extent" to which those in the closing inventory were "included" in the opening inventory could be determined. Accordingly, it was his view that price-index adjustments to retail method inventories, which treated all the items in the department as fungible and made no identification of the items in the two inventories, were not authorized by the statute (Pet. App. 46–47).

In its tax return for fiscal 1942, timely filed on July 15, 1942, Macy reported its inventories with LIFO adjustments on the basis of price indices prepared by the National Industrial Conference Board. It computed its taxes due, however, without such adjustments and paid its taxes on that basis (Pet. App. 5). Although it was barred for other reasons from using LIFO adjustments when it filed its return, that bar was removed in October 1942; and, under the regulations, it still had until March 10, 1943, to make a

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See note 4, *supra*.

retroactive election for that year. That date, however, came and went without Macy filing the required notice of election, allegedly because of the Commissioner's opposition, which at that time had never been the subject of a formal ruling or decision (Pet. App. 5-6).

Some seventy other retailers, including Hutzler Brothers Company, refused to acquiesce in the Commissioner's informal position, however, and filed statements of election to use LIFO adjustments with their tax returns for fiscal years ended in 1942. They adjusted closing inventories to LIFO by using indices prepared by the National Industrial Conference Board (Pet. App. 6, 47).

On February 5, 1944, the Commissioner finally took a formal stand in opposition to the use of price-index adjustments to retail method inventories by issuing a deficiency notice to Hutzler Brothers Company, which had filed an election of LIFO with its return for the fiscal year ended January 31, 1942. (Pet. App. 54-55). The ensuing Tax Court proceedings resulted in a decision in favor of the taxpayer, holding that identification of goods was not necessary under the statute. *Hutzler Brothers Co.* v. *Commissioner*, 8 T. C. 14. The Commissioner acquiesced in the decision and amended his regulations, adding information concerning acceptable price indices and specifically authorizing the election of LIFO by retail method taxpayers. The Commissioner also issued Mim. 6244, 1948-1 Cum. Bull. 21, stating in detail

proper price indices and providing that retailers who had previously filed returns on the basis of LIFO using unacceptable indices could thereafter file amended returns for all "open" years based on indices acceptable to the Commissioner (Pet. App. 6–7).

In September or October, 1948, Macy filed notices of election to use LIFO for its fiscal year 1942, together with claims for refund of taxes paid for that year. In 1948 this year was still "open" for purposes of claiming refund. In 1954 the Commissioner disallowed Macy's claims for refund on the ground that it had failed to file a timely election to use LIFO for its fiscal year 1942—*i. e.*, on or before March 10, 1943—as required by the statute and regulations (Pet. App. 7).

Taxpayers then filed the instant suit for refund. The district court granted the taxpayers' motion for summary judgment on the ground that the regulations in force in 1943 were inapplicable to retail method taxpayers (Pet. App. 29–40). The court of appeals reversed, holding that the regulations were applicable to retail method taxpayers, so far as they went, and hence that taxpayers' right to elect LIFO for their fiscal year 1942 expired on March 10, 1943, pursuant to § 19.22 (d)–3 of Treasury Regulations 103 (Pet. App. 7–12).

ARGUMENT

The sole issue in this case is whether the requirement of § 19.22 (d)–3 of the LIFO regulations, that elections of the accounting method authorized by § 22

(d) of the Code be filed by March 10, 1943 (as to prior years), was applicable to taxpayers claiming a right under that section to make LIFO adjustments to retail method inventories. The court of appeals held that it was. That decision was clearly correct and there is no conflict of decisions or other appropriate ground for review by this Court.

1. Petitioners argue that the regulations issued to implement § 22 (d) (Treas. Regs. 103, §§ 19.22 (d)–1 through 19.22 (d)–3, *infra*, pp. 21–25) interpreted the statute as not authorizing the method they sought to employ and hence that the filing requirements were not applicable to them. That argument is unsound.

a. Petitioners concede that the implementing regulations used "the same arrangement of words" as the statute (Pet. 15). That being so, it is difficult to see how the regulations can be read as being of any narrower scope than the statute itself. Petitioners' sole argument is that, since the Commissioner believed that the statutory language did not authorize the price-index adjustments they sought to make, he must have intended those words, when used in the regulations, to "mean" that such adjustments could not be made. The argument is untenable. That the Commissioner believed that the statute did not apply does not mean that he intended his regulations, cast in the same language, to foreclose the issue.

In any event, it is clear, as the court of appeals pointed out, that the regulations were, if anything, more consistent with petitioners' position than was

the statute itself. For example, § 19.22 (d)-1 authorized the use of the statutory method by "Any taxpayer permitted or required to take inventories pursuant to * * * the provisions of sections 19.22 (c)-1 to 19.22 (c)-8" of the regulations. Since § 19.22 (c)-8 is the provision expressly governing the use of the retail method, that cross-reference on its face seems to have expressly contemplated the election of LIFO by retail method taxpayers. Petitioners rely primarily on the several references in the regulations to "specification" of the "goods" to be inventoried (*e. g.*, §§ 19.22 (d)-2, 19.22 (d)-3), but that language was derived from, and thus was no more stringent than, the statute itself. Clearly, therefore, so far as the regulations elaborated on the statutory requirements at all, they were, as the Tax Court recognized in *Hutzler Brothers Co.* v. *Commissioner*, 8 T. C. 14, 28, fully consistent with the use of LIFO adjustments by retail method taxpayers.

Petitioners seek to buttress their argument by pointing out that the regulations *omitted* certain provisions that might have been appropriate if the Commissioner had contemplated that retail method taxpayers would be entitled to adjust their inventories to LIFO by the use of price indices—for example, a prescription of the proper indices to use (Pet. 6, 16). To the extent that that is true,[6] it is irrelevant. The

[6] Petitioners' suggestion that the regulations did not originally provide for departmentalization of inventories (Pet. 16) would not appear to be accurate. Although the sections dealing with the use of the LIFO method did not expressly so provide, § 19.22 (c)-8, the provision generally dealing with the retail

statutory right to the use of the LIFO method was self-executing (except possibly for some provision for the filing of elections) and did not require implementation by the Commissioner—as, indeed, the *Hutzler* case itself establishes. Under § 22 (d) (3), which authorized the Commissioner to prescribe "such regulations * * * as necessary in order that the use of such method may clearly reflect income," there is no doubt that the Commissioner had the *power* to prescribe, for example, appropriate price indices. It is equally clear, however, that he was not required to do so. That he did not, reflects at most his view that the use of price indices was not authorized by the statute and hence that it was not necessary to prescribe them. Moreover, the regulations themselves recognized that they were not intended to spell out every proper method that might be used and concluded by authorizing "any other proper method which, in the opinion of the Commissioner, clearly reflects income" (§ 19.22 (d)-2 (4) (d)). Clearly, therefore, if retail method taxpayers were entitled under the statute to make price-index adjustments to their inventories, nothing in the regulations precluded them from doing so or from using any price index that seemed to them appropriate. If the Commissioner later disapproved of the price index chosen, that could mean at most only a recomputation on the basis of an acceptable index—as, indeed, proved to be true as to the many retail method taxpayers who did make a timely election.

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method (and to which a cross-reference is made in the LIFO provisions, see § 19.22 (d)-1) did specifically provide for departmentalization of inventories and for various cost adjustments to eliminate distortions from the retail method.

It is clear, therefore, that petitioners' failure to file a timely election was not because anything in the regulations precluded them from doing so. At most it was solely because the Commissioner in informal conferences took the view that the method they sought to use was not authorized by the statute. But the petitioners were free either to acquiesce in that view or, if they thought it erroneous, to file a timely election and challenge it. Obviously the fact that their claim would be resisted could not relieve them of the obligation to assert it. Indeed, even where the Commissioner challenges action which he had previously approved, the taxpayer is not entitled to rely upon the erroneous interpretation of law upon which the approval was based. *Automobile Club* v. *Commissioner,* 353 U. S. 180. And here the Commissioner is not challenging any action taken by petitioners in "reliance" upon his advice. It is the petitioners who are now claiming that they were entitled to do something else. In effect, they are simply seeking a benefit which they failed to claim within the time allowed by law, allegedly because they were told by an adversary (quite accurately) that the claim would be resisted.

b. In any event, even if the regulations *had* interpreted the statute as not authorizing the use of LIFO adjustments by retail method taxpayers, it would by no means follow that the *filing* requirement would not be applicable to anyone who sought to challenge that interpretation. Section 19.22 (d)–3 of the regulations provided that "The elective inventory method may be adopted and used only if the taxpayer files

[prior to March 10, 1943 [7]] * * * a statement of his election to use such inventory method." In terms this applied to *anyone* seeking to use the elective method, and its clear meaning was that *any* election to use LIFO had to be filed within the time specified.

Nor is there any reason to construe the filing requirement as not applying to an election by a taxpayer whose right under the statute to make the election was questioned by the Commissioner. The purpose of requiring a taxpayer to make a binding election in advance was to prevent him from waiting to see the outcome and then recomputing his taxes on the method producing the least tax. That purpose is equally as applicable to a taxpayer whose right is disputed as it is to one whose right is clear. To impute to the Commissioner a purpose to prescribe a time limit only for elections of methods clearly within the statute and to impose no limit on the election of methods he considered not to be within the statute would be to ignore the whole purpose of the requirement.

Petitioners' sole reliance for their basic premise is upon *Pictorial Review Co.* v. *Helvering*, 68 F. 2d 766 (C. A. D. C.). The very basis of that decision, however, was the court's holding that the original regulation there involved was a valid exercise of the Commissioner's delegated power to *bar* the taxpayer from filing a consolidated return and operated by force of law to *require* the taxpayer to file a separate return. It followed that, since the taxpayer in fact had no

[7] See note 4, *supra*.

right to file a consolidated return, its failure to do so was not an "election" which prevented it from doing so when the regulation was changed. Here, on the other hand, the regulations are not claimed to have been anything other than "interpretive" and there is no suggestion that the Commissioner purported to exercise a delegated power to prescribe what methods of inventory accounting could be used. To the contrary, it is established by the *Hutzler* case that the regulations did *not* operate to preclude persons in petitioners' position from adopting the controverted method. Hence, unlike the taxpayer in *Pictorial Review*, the petitioners here had a complete and present right in 1942 to make the now-desired election. Having chosen to acquiesce in the Commissioner's view rather than exercise their existing right to file an application and challenge his interpretation of the statute (whether or not embodied in the regulations), there is no reason now to relieve them from the consequences of their choice.[8]

2. The conflict asserted by taxpayers does not exist. To the contrary, the instant decision by the Second

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[8] Petitioners' characterization of the *Pictorial Review* case as holding "that the failure of Excella to challenge the initial regulations did not bar its right of election" (Pet. 15) is simply erroneous. The whole point of the decision was that the initial regulations were valid and binding and *could not* have been successfully challenged. Petitioners' alternative (and, it would seem, inconsistent) statement of the holding as being "that, not until the initial regulations had been amended * * * did Excella's right of election come into being" (*ibid.*) is, of course, quite accurate, but it has nothing to do with this case where the "right of election" was admittedly "in being" all of the time.

Circuit is in accord with the only other decision squarely in point, *i. e.*, the recent ruling of the Court of Claims in *Kaufmann & Baer Co.* v. *United States*, 137 F. Supp. 725, certiorari denied, 352 U. S. 835. There, as here, a retail method taxpayer wished to adopt LIFO for its fiscal year 1942, but failed to file an election to do so prior to March 10, 1943, as required by § 19.22(d)–3. It did file an attempted election in April, 1943. The Court of Claims held that the attempted election was not timely under the regulations, and hence found it unnecessary to decide the other issue presented, *i. e.*, whether the taxpayer had effectively revoked the election prior to the litigation.

By contrast, none of the three cases relied on by petitioners is in point. *Pictorial Review Co.* v. *Helvering*, 68 F. 2d 766 (C. A. D. C.), has already been distinguished and, to the extent that it is relevant, supports rather than conflicts with the decision below. *Manhattan Co.* v. *Commissioner*, 297 U. S. 129, has no conceivable relevance to this case: it held that a regulation which was contrary to the statute was null and void and that a subsequent valid regulation could be applied just as though the earlier regulation had never existed.

The only case remotely in point is *Joseph Horne Co.* v. *United States*, 161 F. Supp. 580 (C. Cls.), but, as the opinion below denying rehearing on the basis of this alleged conflict abundantly demonstrates, that decision is in no way in conflict. The taxpayer there (who, unlike Macy, had made a timely election of

LIFO for 1942) was seeking to make a retroactive election to have the involuntary liquidation provisions of § 22 (d) (6) (A) of the Code applied to that year. The court held that the Commissioner had discretionary authority under that section to allow retroactive elections in the case of hardship and had abused that discretion. The only relevance of the LIFO regulations to that issue was the court's apparent view that the original regulations had not prescribed the procedures or standards to be followed by retail method taxpayers in using the LIFO method and that, partly for that reason, no "liquidation" was shown on the taxpayer's return until the Commissioner required it in 1948 to recompute its income for those years with departmental inventories and a different price index. Whether or not that decision was correct,* it was obviously not in conflict with the decision here, as, indeed, is shown by the court's failure to cite or question its own earlier decision in *Kaufmann [illegible] Co. v. United States, supra,* which was fully in accord with the decision in this case.

3. In attempting to demonstrate the importance of the question involved, and alleged inequities in the result reached by the Second Circuit, taxpayers have misconceived the facts. They say that "the Government has announced" the existence of claims, identical with the instant case, aggregating between $300,000,000 and one billion dollars (Pet. 12). This assertion is based upon a press release prepared by the former United States Attorney for the Southern District of

* But see note 6, *supra.*

New York (Pet. App. 89-90). So far as that release may be read as referring to pending claims, it is not accurate. The Internal Revenue Service advises that similar claims now actually pending aggregate only a small fraction of the amounts mentioned by the former United States Attorney. The aggregate amount of similar claims which may be filed in the future is, of course, purely conjectural, although Government estimates have run as high as the figures stated in the press release.

Taxpayers also err in stating that the vast majority of retail method taxpayers have been forced to litigate their right to elect LIFO, and that, if the instant decision stands, that right will be available to "but a handful" of such taxpayers (Pet. 13). Since 1948 the Government has recognized (pursuant to its acquiescence in *Hutzler Brothers Co.*) the right of all retail method taxpayers to make an election of LIFO for any current tax year by filing an election with their return for that year. It is only as to retroactive elections that the Commissioner insists that the cut-off date provided by § 19.22 (d)-3 is binding upon retail method taxpayers—just as it is upon all other taxpayers. As noted above, many retail method taxpayers did elect LIFO in compliance with the time requirements of § 19.22 (d)-3, and their right to use LIFO has not been disputed since 1948. Macy chose not to file a timely election and, as the Second Circuit held, it must abide by the consequences.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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OCTOBER 1958.

APPENDIX

Internal Revenue Code of 1939:

SEC. 22. GROSS INCOME.

* * * * * * *

(c) *Inventories.*—Whenever in the opinion of the Commissioner the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer upon such basis as the Commissioner, with the approval of the Secretary, may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income.

(d) [As amended by Sec. 219 (a) of the Revenue Act of 1939, c. 247, 53 Stat. 862] (1) A taxpayer may use the following method (whether or not such method has been prescribed under subsection (c)) in inventorying goods specified in the application required under paragraph (2):

(A) Inventory them at cost;

(B) Treat those remaining on hand at the close of the taxable year as being: First, those included in the opening inventory of the taxable year (in the order of acquisition) to the extent thereof, and second, those acquired in the taxable year; and

(C) Treat those included in the opening inventory of the taxable year in which such method is first used as having been acquired at the same time and determine their cost by the average cost method.

(2) The method described in paragraph (1) may be used—

(A) Only in inventorying goods (required under subsection (c) to be inventoried) specified in an application to use such method filed at such time and in such manner as the Commissioner may prescribe; and

(B) [As amended by Sec. 118 (a) of the Revenue Act of 1942, c. 619, 56 Stat. 798] Only if the taxpayer establishes to the satisfaction of the Commissioner that the taxpayer has used no procedure other than that specified in subparagraphs (B) and (C) of paragraph (1) in inventorying such goods to ascertain the income, profit, or loss of the first taxable year for which the method described in paragraph (1) is to be used, for the purpose of a report or statement covering such taxable year (i) to shareholders, partners, or other proprietors, or to beneficiaries, or (ii) for credit purposes.

(3) The change to, and the use of, such method shall be in accordance with such regulations as the Commissioner, with the approval of the Secretary, may prescribe as necessary in order that the use of such method may clearly reflect income.

(4) In determining income for the taxable year preceding the taxable year for which such method is first used, the closing inventory of such preceding year of the goods specified in such application shall be at cost.

* * * * * *

(26 U. S. C. 1952 ed., Sec. 22.)

Treasury Regulations 103, promulgated under the Internal Revenue Code of 1939:

SEC. 19.22 (c)-8. *Inventories of retail merchants.*—Retail merchants who employ what is known as the "retail method" of pricing inventories may make their returns upon that basis, provided (1) that the use of such method is designated upon the return, (2) that accurate accounts are kept, and (3) that such method is consistently adhered to unless a change is ap-

thorized by the Commissioner as provided in section 19.41–2. Under this method the total of the retail selling prices of the goods on hand at the end of the year in each department or of each class of goods is reduced to approximate cost by deducting therefrom an amount which bears the same ratio to such total as—

(a) the total of the retail selling prices of the goods included in the opening inventory plus the retail selling prices of the goods purchased during the year, with proper adjustment to such selling prices for all mark-ups and mark-downs,

less

(b) the cost of the goods included in the opening inventory plus the cost of the goods purchased during the year,

bears to (a).

This amount should represent as accurately as may be the amounts added to the cost price of the goods to cover selling and other expenses of doing business and for the margin of profit.

* * * * *

SEC. 19.22 (d)–1. *Inventories under elective method.*—Any taxpayer permitted or required to take inventories pursuant to the provisions of section 22 (c), and pursuant to the provisions of sections 19.22 (c)–1 to 19.22 (c)–8, inclusive, may elect with respect to those goods specified in his application and properly subject to inventory to compute his opening and closing inventories in accordance with the method provided by section 22 (d), as amended. Under this elective inventory method, the taxpayer is permitted to treat those goods remaining on hand at the close of the taxable year as being:

First, those included in the opening inventory of the taxable year, in the order of acquisition and to the extent thereof, and

Second, those acquired during the taxable year.

This elective inventory method is not dependent upon the character of the business in which the taxpayer is engaged, or upon the identity or want of identity through commingling of any of the goods on hand, and may be adopted by the taxpayer as of the close of any taxable year beginning after December 31, 1938.

* * * * *

SEC. 19.22 (d)–2 [As amended by T. D. 5163, 1942–2 Cum. Bull. 80, and T. D. 5199, 1942–2 Cum. Bull. 81]. *Requirements incident to adoption and use of elective method.*—The adoption and use of the elective inventory method is, by section 22 (d) and regulations thereunder, made subject to the following requirements:

(1) The taxpayer shall file an application to use such method, specifying with particularity the goods to which it is to be applied;

(2) The inventory shall be taken at cost regardless of market values;

(3) Goods of the specified type included in the opening inventory of the taxable year for which the method is first used shall be considered as having been acquired at the same time and at a unit cost equal to the actual cost of the aggregate divided by the number of units on hand. The actual cost of the aggregate shall be determined pursuant to the inventory method employed by the taxpayer under the regulations applicable to the preceding taxable year with the exception that restoration shall be made with respect to any write-down to market values resulting from the pricing of former inventories;

(4) Goods of the specified type on hand as of the close of the taxable year in excess of what were on hand as of the beginning of the taxable year shall be included in the closing inventory, regardless of identification with specific invoices, at costs determined as follows:

(a) By reference to the actual cost of the goods most recently purchased or produced;

(b) By reference to the actual cost of the goods purchased or produced during the taxable year in the order of acquisition;

(c) By application of an average unit cost equal to the aggregate cost of all of the goods purchased or produced throughout the taxable year divided by the total number of units so purchased or produced, the goods reflected in such inventory increase being considered for the purposes of section 22 (d) as having been acquired all at the same time; or

(d) Pursuant to any other proper method which, in the opinion of the Commissioner, clearly reflects income.

Whichever of the several methods of valuing the inventory increase is adopted by the taxpayer and approved by the Commissioner shall be consistently adhered to in all subsequent taxable years so long as the elective inventory method is used by the taxpayer;

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(5) The taxpayer shall establish to the satisfaction of the Commissioner that the taxpayer, in ascertaining income, profit, or loss for the taxable year for which the elective inventory method is first used or for any subsequent taxable year, for credit purposes or for the purpose of reports to shareholders, partners, or other proprietors, or to beneficiaries, has not used any inventory method other than that referred to in section 19.22 (d)–1 or at variance with the requirement referred to in paragraph (3) of this section, the taxpayer's use of market value in lieu of cost or his issuance of reports or credit statements covering a period of operations less than the whole of the taxable year not being considered at variance with this requirement;

(6) Goods of the specified type on hand as of the close of the taxable year preceding the taxable year for which this inventory method is first used, whether such preceding taxable year began before or after December 31, 1938, shall be included in the taxpayer's closing inventory for such preceding taxable year at cost determined in the manner prescribed in paragraph (3) of this section;

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SEC. 19.22 (d)-3 [As amended by T. D. 5199, *supra*]. *Time and manner of making election.*—The elective inventory method may be adopted and used only if the taxpayer files with his return for the taxable year as of the close of which the method is first to be used (or, if such return is filed prior to March 10, 1943, the ninetieth day after the approval of Treasury Decision 5199, then at any time prior to such date), in triplicate on Form 970 (revised), and pursuant to the instructions printed thereon and to the requirements of this section, a statement of his election to use such inventory method. Such statement shall be accompanied by an analysis of all inventories of the taxpayer as of the beginning and as of the end of the taxable year for which the elective method is proposed first to be used, and also as of the beginning of the preceding taxable year. In the case of a manufacturer, this analysis shall show in detail the manner in which costs are computed with respect to raw materials, goods in process, and finished goods, segregating the products (whether in process or finished goods) into natural groups on the basis of either (1) similarity in factory processes through which they pass, or (2) similarity of raw materials used, or (3) similarity in style, shape, or use of finished products. Each group of products shall be clearly described.

The taxpayer shall submit for the consideration of the Commissioner in connection with the taxpayer's adoption or use of the elective inventory method such other detailed information with respect to his business or accounting system as may be at any time requested by the Commissioner.

As a condition to the taxpayer's use of the elective inventory method, the Commissioner may require that the method be used with respect to goods other than those specified in the taxpayer's statement of election if, in the opinion of the Commissioner, the use of such method with respect to such other goods is essential to a clear reflection of income.

Whether or not the taxpayer's application for the adoption and use of the elective inventory method should be approved, and whether or not such method, once adopted, may be continued, and the propriety of all computations incidental to the use of such method will be determined by the Commissioner in connection with the examination of the taxpayer's returns.